Old trust deeds, modern challenges: court approves trust amendments (including tax benefits) in absence of amendment power

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As we head towards the end of the financial year, our focus often turns to tax planning and future strategies. However, a recent trust case has emerged, reminding anyone working with trusts to reflect on the past while balancing the needs of current and future generations.

The case, *Re EM McPherson Settlement [2024] VSC 744* (**McPherson**), serves as an important reminder of the consequences when a trust deed lacks the modern flexibility and provisions that we often take for granted. Family and other trusts typically last for many generations - in South Australia, some can even exist indefinitely! Over time, laws change, particularly federal and state tax laws. As a result, trust deeds may need to be updated to ensure they remain commercially viable and continue to serve both family and tax planning purposes. *McPherson* highlights that making these changes is not always straightforward.

THE ISSUE IN MCPHERSON

In this case, the trust deed was not only an old deed lacking many trustee powers we expect in today's deeds, but it also lacked a variation/amendment power generally found in modern and well drafted old deeds. Without such a power, the trustee was unable to introduce the flexibilities required to allow the trust to operate efficiently including, under current tax laws.

The trustee therefore sought approval from the Court under section 63A of the *Trustee Act 1958 (Vic)* to make several amendments. The key changes requested, and their outcomes were as follows

Extension of vesting date: APPROVED

Most modern trust deeds adopt the standard perpetuity period of 80 years, except in South Australia, where there is no maximum perpetuity period. Notably, in Queensland, it has been recently extended to 125 years.

In *McPherson*, the original vesting date of the trust was 30 June 2030. However, the Court approved an extension of the vesting date to 80 years from the creation of the original deed in 1972 (making it 30 June 2052). In making this decision, the Court carefully considered the interests of all beneficiaries, including existing, minor, and unborn beneficiaries, who the Court noted would all benefit from the extension.

Importantly, for the current beneficiaries, the extension deferred a perceived adverse taxation consequence that would have arisen from the early vesting of the trust (ie 30 June 2030). While the Court acknowledged that tax planning was a significant motivation for seeking the extension, it clarified that this alone was not a sufficient reason to decline the application. In light of the tax consequences, both the Federal Commissioner of Taxation and the Commissioner of State Revenue were informed of the proceedings, however both declined to join the proceedings.

Broadening beneficiaries: APPROVED

The deed had a relatively narrow number of beneficiaries. The trustee was successful in its application to have that broadened to include related companies and trusts as beneficiaries. The Court provides a helpful discussion in the decision on why this change *did not* trigger a resettlement of the trust. A contrary conclusion may have enlivened federal tax and state duties.

Tax modernisation amendments: APPROVED

Powers were permitted to be included in the deed to provide for certain flexibility. This included the trustee's power to hold assets on sub-trusts, streaming powers, and to determine the definition of income. We discuss the importance of these amendments in further detail below.

Insertion of a general amendment power: REJECTED

Here, the Court took a more cautious stance when asked to insert a general amendment power. The Court reiterated that inserting broad powers - especially where minor and unborn beneficiaries are involved - is unlikely to succeed. The Court favoured specific, well-justified amendments over sweeping changes with uncertain implications as it is difficult to determine how they will affect all beneficiaries.

Unfortunately for the trustee in McPherson, this means that any changes to the deed going forward will need Court approval. This highlights the importance of ensuring applications to the Court for amendment are fulsome so as to not incur further costs in returning to Court down the track. Of course, it is difficult even for the most astute legal advisor to contemplate all possible powers that may be required in the future, as the law inevitably changes.

WHY UPDATE YOUR TRUST DEED?

Many older trust deeds (particularly those established before 2011) likely need to be updated to address key legal and tax changes. We regularly prepare these deeds for clients with the main drivers being:

- **Tax issues**: The landmark case of *Bamford* and subsequent legislative changes in the *Tax Laws Amendment (2011 Measures No. 5) Act 2011* reshaped how trust income is treated from 2011. The definition of income and presence of streaming powers in deeds prior to that time may be absent, unclear or outdated, creating unintended tax consequences and restricting flexibility in a trust. Examples include tax effectively streaming capital gains and franked dividends to appropriate beneficiaries. As discussed above, and in stark contrast to the general anti avoidance rules contained within the ITAA 1936, an application to the court to amend a trust deed with the sole proviso of seeking a tax advantage will likely attract no criticism from the Court, if the tax advantage sought is in the best interests of all beneficiaries (including those unborn). In most instances, that benefit can readily be demonstrated.
- **Succession planning**: Succession of the usual "controller" roles such as appointor, trustee, or guardian may also be absent, unclear or inconsistent with the intentions of parties. It is important to update deeds, where appropriate powers permit, to ensure succession (consistent with the Wills and other estate planning documents of the principals who established the subject trust) is catered for and in line with their expectations. This is especially important if the exercise of certain powers in the deed require the approval of one of those officeholders (e.g. the principals or the legal personal representatives of the principal(s)). Without proper succession of the controller roles the relevant powers may not be exercisable after death and thus becomes redundant. That may hinder actions of the trustee or the controllers going forward in the absence of a costly "visit or visits" to the Supreme Court of the relevant state concerned to obtain the necessary amendment required.
- **Beneficiary class**: It is essential to ensure the beneficiary class reflects your (the principals) current expectations and circumstances. This may include clarifying whether adopted children are included in the deed's descendant definition. Alternatively, which children or others become the controller(s) of the trust and its assets when the principals pass or lose legal capacity. Another example would be in cases of family breakdowns and ensuring the relevant parties are included only. However, trustees should be mindful of potential claims for excluding named beneficiaries from distributions, as highlighted in the recent *Owies* case. To mitigate such risks, discuss with your legal advisor whether it would be more appropriate to obtain a deed of disclaimer from the exiting beneficiary to formally renounce their interest and/or related steps.

- **Flexibility**: However, noting that a lack of powers to vary the deed could necessitate costly court involvement, as seen in McPherson.

If the trust deed is defective and lacking in suitable variation powers, the involvement of the principals of the subject trust in the Supreme Court application generally would be an advantage. If they are dead or lacking capacity, that may make the application more difficult or require a different strategy to best achieve a suitable variation of the constituent trust deed. Hence its best to consider the need for a variation as soon as possible while the principals are alive and have capacity to participate in the variation process. If not, such an application may still be possible, but depending on their relevant circumstances, may prove harder and more costly.

WHY THIS MATTERS TO YOU

This case is a reminder that many older trusts may lack the powers needed to adapt to today's legal and tax landscape. Likewise for the estate planning and succession needs of the principals of the trust concerned. However, some of the challenges discussed in this article may arise even in trust deeds have been created in recent years.

Drafting oversights or failure to consider emerging legal, succession and tax complexities may leave trustees and controllers constrained. While Court approval can offer a solution, it comes with the burden of time, cost, complexity and uncertainty.

For accountants and advisors working with trusts both new and old, it is worth asking the question: Do your clients' trusts have the necessary tools to evolve, or could they face similar hurdles?

We can assist with:

- Establishing trusts with broad flexibilities and powers.
- Reviewing trust deeds to determine the extent of existing powers alone or in conjunction with the estate planning requirements of the principals of the subject trust.
- Modernising trusts to align with current legal principles and provide clarity and flexibility for the trustee; and
- Assisting with applications to the Supreme Court where necessary.

If this case raises red flags for you, or if you want to ensure your clients' trust deeds are future-proof, we're here to help. Feel free to get in touch with one of our trust law specialists.